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No. 354

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IN THE

Supreme Court of the United States

GEORGE E. MORTON, TRUSTEE, AND CITY NATIONAL BANK, AS TRUSTEE, AND INDIVIDUALLY ..... *Petitioners,*

v.

DARDANELLE SPECIAL SCHOOL DISTRICT NO. 15 OF YELL COUNTY, ARKANSAS ..... *Respondent.*

BRIEF FOR RESPONDENTS

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DARDANELLE SPECIAL SCHOOL DISTRICT NO. 15 OF YELL COUNTY, ARKANSAS ..... *Respondent.*

BRIEF FOR RESPONDENTS

A.

STATEMENT OF THE CASE

The issues involved in this petition are simple questions of law that have been decided adversely to the petitioners in both the District Court and the Circuit Court of Appeals not only in this case but also in a former case that was based upon an almost identical deed of trust and pledge of school revenues. The Supreme Court of Arkansas has consistently denied the relief sought. As we shall show in the argument, the Circuit Court of Appeals for the Eighth Circuit has analyzed one by one all the Arkansas cases that discuss the power of a board of directors of an Arkansas urban school district under the statutes involved, to pledge the general tax revenues of the district for the payment of bonds and reached the conclusion the power never

existed and there was no contractual obligation that could be impaired.

The Dardanelle Special School District of Yell County, Arkansas, issued bonds in the amount of $55,000, dated March 1, 1926, and in the amount of $105,000 dated January 1, 1931, which issues total $160,000.

With the beginning of the financial depression the Dardanelle Special School District began to default in the principal and interest payments of its bonds.

January 9, 1935, the trustee of the first issue filed a bill in equity praying that the county treasurer and the directors of the district be enjoined from paying out any further revenues of the district. The bill also asked that the directors be required to set up a building fund and pay into the same the equivalent of nine mills of the district's taxes.

January 25, 1935, an order was entered directing the defendant district to set up the building fund as prayed in the bill. Subsequent to that time the validity of the second bond issue was contested by other bondholders. But June 28, 1938, the court entered its order declaring the bonds to be valid, and directing the district to continue to set aside and pay over to the bondholders the sum of 9 mills of the district's 18-mill tax. The court expressly retained jurisdiction of all parties and of the cause to enter such further orders as might be necessary.

Finding that one-half of the district's 18-mill tax was not sufficient to take care of the district's indebtedness, the bondholders filed a petition asking that the court enter its order in the case directing the district to pay over all of its revenues from the 18-mill tax to the bondholders.

There followed a delay during this time in which the parties were negotiating with the view of refunding the district's indebtedness. It developed, however, that the bondholders were not willing to reduce the principal and interest of the proposed refunding issue to such an extent that the district would be able to meet their obligations as they accrued.

In the meantime, this Court had decided the Erie Railroad Case, 304 U. S. 64, holding that federal courts were obligated to follow the decisions of the respective state courts in diversity of citizenship cases.

Under the authority of the Erie Case, 304 U. S. 64, the Eighth Circuit Court of Appeals decided the case of *Women's Catholic Order of Foresters* v. *North Little Rock Special School District,* 105 F. (2d) 716, which case held that under the laws of Arkansas, there was no power on the part of the directors of a special school district to set aside a specific building fund tax from year to year in the absence of same being specifically voted by the electors of the district from year to year.

Relying upon the above decisions, the defendant district, in response to the petition by the bondholders for the entire 18-mill tax, filed its motion to dismiss, its answer and its counterclaim. This pleading set up that under the law as it was now expounded by Federal Courts and the Supreme Court of Arkansas, there was no legal authority for the entry of a restraining order directing the setting aside of any portion of the millage of the district.

The bondholders, having originally invoked the jurisdiction of the federal district court on the grounds of diversity of citizenship, filed an amendment to their petition

alleging that to deny them the relief prayed for would constitute an impairment of the obligation of their contract in violation of the Constitution of the United States.

The district court being of the opinion that it should follow the decisions of the Supreme Court of Arkansas, dismissed the petition of the bondholders.

It was found by the court that the electors of the district have never voted a building fund millage tax for the payment of the bonds of the district; that the school district has reduced its operating expenses to a minimum and that it has reduced the salaries of its teachers to such an extent that it is difficult to secure and keep competent teachers; that the district is in default of its insurance premiums and special taxes and is in danger of loss by fire or loss by foreclosure of tax liens and that the district cannot continue to function and serve the community if the order remains in force requiring it to pay over to the bondholders nine mills of its 18-mill tax and that to increase the present millage now paid to the bondholders or to continue same in force will result in closing the schools of the defendant district.

It was agreed by the defendant district that the bondholders were probably entitled to that portion of the revenue derived from the State Apportionment Fund from sources other than the sales tax, and since that amount approximated the amount received from a tax of 6 mills on the assessed valuation of the property in the district, a consent order was entered directing the setting aside of the revenue from six mills of the defendant district's tax until there appeared a discrepancy between the amounts received from

the state apportionment fund and from a 6-mill tax on the assessed valuation of the property within the district.

The decision of the district court was appealed to the Eighth Circuit Court of Appeals at which time all points now raised in the petition for a writ of certiorari were thoroughly briefed and argued before that court.

In affirming the district court, the Circuit Court of Appeals decided the following points: (1) The pledge of the general tax revenues of the district by the board of directors in the bond indenture was, under the laws of the State of Arkansas involved and the decisions of the federal courts, void and unenforceable. (2) That there have been no changes in its decisions by the Supreme Court of Arkansas relative to the law applicable to the rights of the bondholders. (3) That even had there been such a change in its decisions by the Supreme Court of Arkansas, such change would not have constituted an impairment of the obligation of the bondholders' contract in violation of the Constitution of the United States, since such prohibition applies only to impairment by legislative action. (4) And that Amendment No. 11 to the Constitution of the State of Arkansas did not impair the obligation of the contract contained in the 1926 issue, since there was no enforceable obligation which could have been impaired.

From this decision the bondholders have petitioned this Court for a writ of certiorari to the Eighth Circuit Court of Appeals.

B.

STATEMENT OF POINTS ARGUED AND AUTHORITIES RELIED UPON

I.

Petitioners Never Had an Enforceable Contract for Any Tax Revenue

AUTHORITIES

American Exchange Trust Company v. *Trumann Special School District,* 183 Ark. 1041, 40 S. W. (2d) 770;

Horne v. *Paragould Special School District No. 1,* 186 Ark. 1000, 57 S. W. (2d) 568;

Pledger v. *Cuttrell,* 189 Ark. 562, 74 S. W. (2d) 646;

Schmutz v. *Special School Dist. of Little Rock,* 78 Ark. 119, 95 S. W. 438;

Special School District of Malvern v. *Speer,* 75 F. (2d) 420;

Act 169 of Acts of Arkansas of 1931, page 476;

C. & M. Digest of Statutes of Arkansas, Section 8977;

Section 10, Article 1, Constitution of United States;

Section 1, Amendment 14 to Constitution of United States;

Amendment No. 11 to Constitution of Arkansas.

II.

There Is No Constitutional Question to Be Passed Upon

AUTHORITIES

Erie Railroad Co. v. *Thompkins,* 304 U. S. 64;

Horne v. *Paragould Special School District No. 1,* 186 Ark. 1000, 57 S. W. (2d) 568;

Pledger v. *Cuttrell,* 189 Ark. 562, 74 S. W. (2d) 646;

Schmutz v. *Special School Dist. of Little Rock*, 78 Ark. 119, 95 S. W. 438;

Tidal Oil Company v. *Flanagan*, 263 U. S. 444, 68 L. Ed. 382;

Act 169 of the Acts of Arkansas of 1931, page 476;

Act 169 of Acts of Arkansas of 1931, Section 60;

Pope's Digest of the Statutes of Arkansas, Section 11686;

Amendment No. 11 to Constitution of Arkansas.

III.

Discussion of Petitioners' Argument

AUTHORITIES

Hubble v. *Leonard*, 6 F. Supp. 145;

Shapleigh v. *San Angelo*, 167 U. S. 648;

Special School District of Malvern v. *Speer*, 75 F. (2d) 420;

U. S. v. *City of New Orleans*, 98 U. S. 381, 25 L. Ed. 225.

C.

ARGUMENT

I.

PETITIONERS NEVER HAD AN ENFORCEABLE CONTRACT FOR ANY TAX REVENUE

Petitioners contend that the laws and decisions of the Supreme Court of the State of Arkansas, existing at the time of the issuance of petitioners' bonds and under the authority of which they were issued, entered into and became a part of the contract between the respondent and petitioners, in such a way that the obligation of the contract could not thereafter be in any way impaired or its fulfillment hampered or obstructed by a legislative or judicial fiat; but the petitioners cannot, under the laws and decisions of the Supreme Court of Arkansas as they existed on March 1, 1926, and January 1, 1931, the dates when these bonds were issued, definitely determine what rights they had for the payment of those bonds and whether there was any definite pledge of revenues of the defendant district. A review will show that no decision of either the Arkansas Supreme Court or of this court has ever stated definitely that the directors of a city special school district, prior to Act 169 of 1931, (page 476 of Acts, 1931) had the power to create a building fund from the first revenues of the district and definitely pledge that building fund to the payment of school bonds.

The law of Arkansas, prior to Act 169 of 1931, raised serious doubt as to just what fund, if any, could be pledged by a city special school district for the payment of its bonds. The law definitely gave rural special and consolidated districts the right to vote a continuing millage for a

building fund that would run until all the bonds and interest were paid. But the city special district did not have the power to vote a building fund.

The only case dealing with the rights of bondholders that had been decided by the Arkansas Supreme Court at the times these bonds were issued was the case of *Schmutz* v. *School District of Little Rock*, 78 Ark. 1118, 95 S. W. 438, in which the Arkansas Supreme Court, construing a special act, made the statement usually quoted which is as follows:

> "* * * The act under which the bonds were issued provides that the evidence of indebtedness issued by the district shall be 'paid out of the building fund in the order of their date, *as the building fund is provided and collected by successive levies.* This, in effect, pledges the building fund of the district, *whatever that may be,* to the payment of the bonds. Besides, as the bonds are valid obligations, it was evidently the intention of the Legislature that they should be paid out of the revenues of the district, and they are therefore a charge against such revenues as any other valid debt would be. * * *" (Italics supplied.)

This seemed to carry the power to pledge revenue, but if we examine the wording in the light of later decisions, it is not as positive as it first appears to be. We note, upon re-examination, the phrase, "This, in effect, pledges the building fund of the district, whatever that may be, to the payment of the bonds." The opinion did not say that the directors could pledge the revenues of the district but that the statute in effect pledged the building fund, and the court expressly states that there is uncertainty as to what a building fund may be. The building fund in the rural special or consolidated district was the voted millage, but there was no millage in the case of the city special district.

The confusion grew out of the fact that the law was not a well formulated program but rather a growth from the old law which required even city special districts to submit to the voters of the district the question of bonds and, at the same time, submit also the question of a millage to provide a building fund to pay these bonds. When the law was amended to omit the requirement of an election on the question of issuing bonds, it left the phrase, "building fund," in the law but made no provision for establishing such a building fund. The boards of directors of various city special school districts undertook to supply this omission by an artificial building fund created by setting aside out of first revenues of the district a certain estimated amount necessary to pay bonds and interest in each year and terming it the building fund, and, then pledging this artificial building fund for the payment of the bonds. Now this is exactly what has happened in the instant case. These bonds were issued when there was no authority in the School District to vote a building fund, but the School Board tried to supply this lack of statutory authority by the creation of an artificial building fund in which it set aside the first revenue for the payment of bonds. There was no authority in the law for the so-called building fund and the bondholders had no certain fund available for their protection by reason of the action.

Going back to the part of the Schmutz case, *supra*, just quoted, in addition to saying that the statute pledges the building fund, whatever that may be, the decision goes on to say that the bonds shall be paid out of the building fund as it is provided and collected by successive levies. This was thought to mean that while there was no way to compel

the district to levy and collect taxes, yet if it did levy and collect taxes, the first revenues would be pledged.

Again, going back to the Schmutz decision we find the conclusion (pp. 122, 123) which is rarely quoted but in view of later decisions is now quite illuminating. The court said:

> "* * * But, if we concede that the directors had no authority to pledge the revenues of the district in that way, this would not justify us in enjoining the issuance of the bonds, for, if the directors exceeded their powers in that respect, this provision of the bond would not estop the district, or bind the successors in office of the directors who issued the bonds. For, the question of whether the district has power to pledge its revenues was not committed to those directors for ascertainment and decision. Their decision on that matter is no more binding than their opinion on any other question of law affecting these bonds."

It will thus be noted that the Schmutz case definitely raises doubt as to the authority of the school directors to pledge the revenues of the school district at all. As long as the city special school district paid their bonds and interest this decision was sufficient, but when defaults began to occur it became important to obtain a more definite statement of the rights of bondholders to some definite share of school revenue.

American Exchange Trust Company v. *Trumann Special School District*, 183 Ark. 1041, 40 S. W. (2) 770, was an effort to clarify these rights and to enforce the agreement on the part of the district to set up this artificial building fund for the protection of the bonds. If the bonds were simply to be paid out of revenue as any other obligation of the district, then they would have no priority but would have to be registered as school warrants and

paid in order of registration; this was unsatisfactory because it meant delay and uncertainty as to time of payment. It was the contention of the bondholders that the agreement of the district to set up the building fund out of first revenues could be enforced so that a definite fund for the payment of the bonds and interest would be available whenever they were presented. The court refused to require the Trumann Special School District to set up a building fund. It said it was true that the bonds were a charge against the whole revenues of the district, but the district should not be compelled to set aside revenues into a building fund for the payment of unmatured bonds. The decision was certainly most unsatisfactory because it denied the prayer to enforce the agreement to provide a building fund and left the bondholders in the position of common creditors of the district, without a definite share of the revenues and if the district should refuse to vote a tax at all, without any revenue, although the mortgage lien remained on the real property. What benefit was it to say to the bondholders that the school directors could provide a building fund if the court refused to enforce their agreement to do so?

The Eighth Circuit Court of Appeals has examined the Schmutz case and the Trumann case on which appellants place their main reliance, in the case of the *Women's Catholic Order of Foresters* v. *Special School District of North Little Rock,* 105 F. (2d) 716, and analyzes them on page 719 as follows:

> "The language of these two cases lends some plausibility to the position taken by the plaintiff. But the question is one inherently 'local in origin and content.' In the Schmutz case the court did not hold that the directors had power to pledge the revenues of the

district, but rather that the statute in effect pledged the building fund, and the court seemed to be in doubt as to what the building fund might be. These bonds were issued in 1924, at a time when there was no specific authority in the directors of the school district to vote a building fund, but nevertheless, the directors assumed the authority to create such a fund. It is noticeable too that the decision in the Schmutz case points out that the bonds therein involved should be paid out of the building fund as provided and collected by successive levies. But we think it significant that in the Schmutz case the court should have pointed out that even if the directors had no authority to pledge the revenues, the issuance of the bonds should not be enjoined 'for if the directors exceeded their powers in that respect this provision of the bond would not estop the district or bind the successors in office of the directors who issued the bonds. For the question of whether the district has power to pledge its revenues was not committed to those directors for ascertainment and decision.'

"*In American Exchange Trust Co.* v. *Trumann Special School District, supra,* the bondholders contended that the agreement of the district to set up a building fund out of the first revenues was enforceable and if enforced a definite fund for the payment of the bonds and interest would be available. The court, however, refused to require the school district to set up such a fund. It said that the bonds were a charge against the whole revenues of the district but the district should not be compelled to set aside revenues into a building fund for the payment of unmatured bonds. This in effect left the bondholders in the position of common creditors of the district. In fact, in the Schmutz case, the court in referring to the bonded indebtedness being a charge against the revenues of the district, apparently spoke in the most general terms because it reached its conclusion simply because they were valid obligations and they were 'a charge against

such revenues *as any other valid debt would be'.*" (Italics in opinion.)

The case of *Horne* v. *Paragould Special School District No. 1,* 186 Ark. 1000, 58 S. W. (2d) 568, squarely raised the rights of bondholders to school revenues under a building fund provision and pledge that are substantially the same as in the case at bar. The district had an approximate total of $400,000.00 in outstanding bonds of several issues, some of which were issued in 1924 and 1925. In 1931, a six-mill tax was voted for building or bond payment fund and twelve mills for general school purposes. The six-mill tax produced $11,020.62 annually, but the annual interest requirements alone were $20,000.00 and principal and interest together were over $40,000.00. It was evident that six mills would not pay the bonds and interest as they became due, in fact it would never pay the interest alone at the contract rate.

The Arkansas Supreme Court re-examined its former decisions and held that the bondholders were limited to the six mills voted for a building fund. We think the decision controls this case. The court said:

> "The issue to be determined by this court on this appeal is succinctly stated by counsel for appellee as follows: 'Whether or not the directors of an urban special school district under the law as it stood at the time of the issue of the said bonds had authority of law to make, without submission of the question to the electors of the district, a pledge of all the proceeds of the 18-mill tax for the sole purpose of paying bonds and interest when future levies thereof were not and could not be within the control of the school board (or of the Legislature itself, for that matter) but depended for their existence on the favorable annual vote of the electors of the district.' * * *

"Appellant contends that Section 8977, Crawford & Moses' Digest, and the decisions of this court in *Schmutz* v. *Special School District of Little Rock*, 78 Ark. 119, 95 S. W. 438, and *Am. Ex. Trust Co.* v. *Trumann Special School Dist.*, 183 Ark. 1041, 40 S. W. (2d) 770, support his contention that all the revenue may be pledged, said section provides: 'To borrow money and mortgage the real property of the district as security therefor under such conditions and regulations as to amount, time and manner of payment as the board of directors of said school district shall prescribe.' This section authorizes the directors to mortgage the real property of the district to secure the money borrowed, and permits them to fix the time and manner of payment. It does not authorize them in specific terms to pledge any revenue, and it could not authorize them to pledge any part of the 18-mill tax voted for any other purpose. Neither the Schmutz nor the Trumann Special School District case, *supra*, discussed the exact question now under consideration. * * * "

The gratuitous statement on page 35 of petitioners' brief that the Horne case was a "friendly suit" is not correct; and the briefs will show that the case was vigorously contested and the identical arguments relative to the impairment of contract raised by petitioners here were presented to and adversely ruled upon by the Supreme Court of Arkansas.

Because the case of *Pledger* v. *Cuttrell*, 189 Ark. 562, 74 S. W. (2d) 646, which is the last statement of the Supreme Court of Arkansas on the subject of the division of school revenue between maintenance and operation of schools and the retirement of existing debts, quotes extensively from the Paragould case, it will be enough to quote from the Pledger case as follows:

"The school fund here under consideration arises and accrues exclusively under Amendment No. 11 to

the Constitution of 1874, which provides: 'The General Assembly shall provide by the general laws for the support of common schools by taxes which shall never exceed in any one year three mills on the dollar on the taxable property in the State, and by an annual per capita tax of one dollar, to be assessed on every male inhabitant of this State over the age of twenty-one years. Provided, that the General Assembly may, by general law, authorize school districts to levy by a vote of the qualified electors of such districts a tax not to exceed 18 mills on the dollar in any one year for the maintenance of schools, the erection and equipment of school buildings and the retirement of existing indebtedness for buildings. Provided, further, that no such tax shall be appropriated for any other purpose nor to any other district than that for which it is levied.

"It appears from the 11th amendment last quoted that it levies no taxes and that no tax may be levied thereunder save by an affirmative vote of the qualified electors of the school district in which such levy is sought, and then such levy is limited to 18 mills on the dollar in value for any one year. Therefore it definitely appears that the levy of any tax under this amendment is exclusively optional with the qualified electors in the school district affected. On the question here under consideration we decided in *Horne* v. *Paragould Special School District*, 186 Ark. 1000, 57 S. W. (2d) 568: 'Three purposes are named in the amendment (1) "for the maintenance of schools"; (2) for "the erection and equipment of school buildings"; and (3) for "the retirement of existing indebtedness for buildings." And it is then provided "that no such tax shall be appropriated for any other purpose nor to any other district than that for which it is levied." This appears to be very simple language, unambiguous, and not difficult of comprehension. The electors of any school district may vote a tax at any rate they wish for any or all said purposes, provided the tax voted for all does not exceed 18 mills. For instance, they might vote 6 mills for bond and 12 mills for school

purposes, as they did in this case, and, when so levied and collected, neither sum could "be appropriated for any other purpose * * * than that for which it is levied." In other words, the 12 mills voted for school purposes could not lawfully be appropriated for payment of bonds or the interest thereon, nor could the 6 mills voted for bond purposes be appropriated for schools. Such is the plain language of the amendment. No other construction can be given, and any other in the present case would probably work disaster to both parties. For, since the voting of any tax for any purpose is optional with the district electors, the taking of the 12 mills voted for general school purposes to pay bonds would close the schools and keep them closed for many years, it would seem reasonably certain the electors would not vote a tax on themselves and have no schools. The bondholders would lose the 6-mill tax now being received, a substantial loss to them, and the district would be without a free public school for years to come, which would be disastrous to it and its people.'

"It follows from what we have said that neither creditors nor any one else can acquire a vested right or interest in or to any levy of taxes under Amendment No. 11 or to any part thereof until same has been voted by the qualified electors each year." * * *

This case finally settled the law in Arkansas, but meanwhile certain bondholders tried to get the federal courts to enforce their contract for a building fund and pledge thereof made by an urban special school district. This was the case of *Special School District of Malvern, Hot Spring County, Arkansas, et al.*, v. *Speer*, 75 Fed. (2d) 420, decided on February 5, 1935, but the court definitely refused to pass upon the merits of the controversy, and said: "It is perhaps sufficient to say that the case presents difficult and doubtful questions of law, including the question of the constitutionality of certain state statutes as applied to the facts involved." The court held that the district

court had not abused its discretion in refusing to dissolve an injunction but said:

> "An examination of the record discloses the execution of the bonds, the default in payment of interest thereon, the execution of the trust deed, which in form admittedly pledges the district to establish a building fund, and pledge the revenues to sustain such fund. Whether or not the defendants may defeat these contracts depends upon the construction to be given to certain statutes of Arkansas and certain decisions of the Supreme Court of Arkansas, and may involve the question of the constitutionality of certain of these statutes. In this condition of the record, we are clear that we should not attempt to pass on the merits of this case, and we refrain from expressing any opinion on its merits, further than to say that it involves difficult, if not doubtful, questions of law."

Petitioners go into an extended discussion of the argument that the Horne and Pledger cases impair the obligations of their contract in violation of Section 10 of Article I and Section 1 of the 14th Amendment to the Constitution of the United States. The cases which they cite in support of this argument are the cases that have been the familiar authorities for this argument throughout the ten years that the meaning of the Arkansas school law has been under judicial interpretation. The contracts in this case are practically identical with the contract involved in the case of *Women's Catholic Order of Foresters* v. *Special School District of North Little Rock,* 105 F. (2d) 716, and the arguments which are advanced here and many of the authorities cited here are the same arguments and the same authorities submitted in that case, which was decided July 27, 1939. We take the position that there has been no new question introduced in this case, except the claim of the appellants that the decisions of the Arkansas Su-

preme Court, together with Amendment No. 11 to the Constitution of Arkansas and Act 169 of 1931, impair the obligations of their contracts in violation of the restraints of the Federal Constitution. In order to have a basis for consideration for this question, there must be an enforceable contract to be impaired. Prior to the issuance of these bonds, there was only one Arkansas Supreme Court decision that construed the rights of bondholders in the revenues of a district, and this was the Schmutz case which does not hold that the directors have the right to pledge any revenues.

II.

There is No Constitutional Question to Be Passed Upon

The only colorable claim of impairment which could be made by the petitioners is that the adoption of Amendment No. 11 to Article 14, Section 3 of the Constitution of the State of Arkansas of 1874 constituted an impairment of the obligation of the contract in the bond issue of 1926, executed prior to the adoption of Amendment No. 11.

However, it is easily observed from an examination of the Constitution as it stood prior to the adoption of Amendment No. 11 that the Legislature could authorize a school district to vote 12 mills for school purposes, but could not permit the proceeds from the levy to be diverted to any other purpose than that for which the levy was made.

Amendment No. 11 did nothing more than to increase the permissible millage from 12 mills to 18 mills, if the Legislature by general law permitted the districts to do so, and provided the tax could be voted for the maintenance of schools, the erection and equipment of school buildings,

and retirement of existing indebtedness for buildings. However, the same provision that the revenues could not be diverted to any other purpose was carried in Amendment No. 11.

It was held in the Horne case and the Pledger case that Amendment No. 11 did not levy a tax nor could the bondholders have a vested right in the taxes levied under such authority. By the same reasoning, this rule was applied to the Constitution as it existed prior to the Amendment. As was stated by the Circuit Court, "that which was no an enforceable contract right was not an obligation which could be impaired within the meaning of the constitutional prohibition."

Petitioners take the position that the obligation of their contract has been impaired by the Supreme Court of Arkansas by decisions rendered subsequent to the Schmutz case. As previously stated, the Circuit Court of Appeals held that there has been no change in its decisions by the Supreme Court of Arkansas, but that decisions rendered subsequent to the Schmutz case were but clarifications of that decision.

However, even had there been a distinct reversal of its former decisions by the Supreme Court of Arkansas, such reversals would not constitute an impairment of the obligation of the contract within the meaning of the Constitution of the United States, since such prohibition is directed only to legislative action.

For a considerable period of time there existed the erroneous belief that the obligation of a contract could be impaired by judicial decision. This belief originated in the freedom of the Federal Courts in diversity of citizen-

ship cases to follow the rule of law as it saw fit, and in such cases the Federal Courts frequently refused to follow a change in decisions by a State Court, when to do so would work an injustice.

The case of *Tidal Oil Company* v. *Flanagan,* 263 U. S. 444, 68 L. Ed. 382, very definitely states that a contract can not be impaired by judicial decision.

It is well settled by the Erie Railroad Case, 304 U. S. 64, and those rendered subsequent thereto that the Federal Court must follow the decisions of the State Courts in all questions of general jurisprudence; and it has always been the law that Federal Courts are bound by the laws of the state and the construction placed upon its laws by the highest court in that state. The above statements of law are too well settled to burden this Court with citations and quotations from the cited cases.

It is not the attitude of the Dardanelle Special School District to avoid the payment of its just obligations. It recognizes that the bonds involved in this case are valid and legal obligations of the district. However, the district is encumbered with indebtedness far beyond its ability to pay.

A revolving loan fund has been created in this state to enable districts that are financially embarrassed to borrow money from this fund to retire its bonded indebtedness. It is provided in Section 11686 of Pope's Digest of the Statutes of Arkansas that a loan from the revolving loan fund can be obtained provided it appears that if all of the bonds issued by the district could be bought at the same discount the debt could be reduced to not more than 10% of the assessed valuation of all the real property in the district. The assessed valuation of this district is $729,767,

and on this basis the district could borrow $72,976.70. This is the largest amount which could be borrowed and the only source from which the money could be obtained. The loan would enable the district to pay about 45 cents on the dollar for the face of the bonds, remitting all past due interest. This is all that the bonds are reasonably worth, and though the district is willing to avail itself of the right to a revolving loan, the bondholders are not willing to surrender their bonds. It is also revealed by the record in this case that in 1930 the assessed value of the property in the district was $1,276,645 and it is now only $729,767.

The record also reveals some additional significant facts. At the time the January 1, 1931, bonds were issued the district had outstanding at least $54,000 of the $55,000 issue of 1926. At that time the assessed value of the property in the district was $1,276,645, and the 1931 issue of $105,000 increased the indebtedness of the district to over 12% of its assessed value as it stood at that time. These bonds bore an interest rate of 5½%, an increase of ½ per cent over the earlier issue and is in itself indicative of an increased financial risk. While this second issue is dated January 1, 1931, the deed of trust securing it was recorded on March 24, 1931, at 8 o'clock P. M., whereas Act 169 of 1931 with its emergency clause was approved and became effective on March 25, 1931. Section 60 of said Act provides that no district shall issue bonds that would make the total outstanding bonded indebtedness at that time exceed 7% of the assessed valuation of the real and personal property in the district as shown by the last assessment. Act 169 of 1931 was a sweeping revision of the school laws, and its introduction and passage was given state-wide publicity. The bond issue of 1931 was a patent evasion of that law and

was executed the day before the effective date of Act 169 with its beneficial limitation of 7%. Subsequent events have shown how wise a safeguard both for districts and investors is the 7% limitation on a district's bonded indebtedness.

III.

Discussion of Petitioners' Argument

On page 15 of their brief petitioners make the sweeping statement that the decision of the Circuit Court of Appeals in this case is in direct conflict with an earlier decision by the same court in the case of *Special School District of Malvern* v. *Speer*, 75 F. (2d) 420. We have already shown that the Circuit Court of Appeals specifically refused to pass upon the merits of the issues raised in that case.

The case of *Hubble* v. *Leonard*, 6 F. Supp. 145, cited by petitioners, was a proceeding to enforce the payment of certain highway bonds issued by the State of Arkansas, and had nothing to do with school bonds.

Petitioners state that the State has no power under the Constitution of the United States to give authority to taxpaying voters to impair the obligation of a contract, and cite the case of *Shapleigh* v. *San Angelo*, 167 U. S. 648.

With that statement we are thoroughly in accord. However, the Shapleigh Case was based upon a state statute which permitted the voters to refuse to assume the obligations of a municipality which had been dissolved and a new municipality created in its stead. Such is not the case here. There has been no new statute passed subsequent to these bond issues which in any manner affects these bonds. No new power has been conferred upon the electorate by

the Legislature which was not already in existence at the time of the issue of these bonds.

Petitioners also cite the case of *United States* v. *City of New Orleans,* 98 U. S. 381, 25 L. Ed. 225. In that case bonds had been issued by the City of New Orleans, which issue had been authorized by an act of the legislature of that state. However, the statute failed to provide the machinery for the levy and collection of taxes with which to pay these bonds. In that case the court held that the power to tax to pay for bonds which were authorized by statute was necessarily implied from the statute giving power to issue the bonds. The court makes the following statement which distinguishes that case from the instant case:

> "* * * It is, therefore, to be inferred, as observed by this court in *Loan Asso.* v. *Topeka,* 20 Wall. 660, that when the Legislature of a State authorizes a county or city to contract a debt by bond, it intends to authorize it to levy such taxes as are necessary to pay the debt, *unless there is in the Act itself or in some general statute, a limitation upon the power of taxation which repels such an inference.*" (Italics supplied.)

In the case at bar there is no absence of statutory authority for the levy and collection of taxes by this district. Such authority was in existence at all times prior and subsequent to the issuance of these bonds, such statutes became a part of the contract and are binding upon the district and the bondholders with equal force. The only limitation to be found in the statutes in existence at the time these bonds were issued was the limitation which prevented the directors of the district from making a pledge of a specific portion of the district's revenues which would bind the electors and force those electors to continue to vote this tax from year to year.

D.

CONCLUSION

In conclusion, respondent respectfully submits that petitioners have failed to make any showing which would entitle them to a writ of certiorari under Rule 38(b) of the Rules of this Court.

Certainly there is no conflict of decisions between the various circuit courts of appeal as contemplated by the first part of this rule. This case involves an interpretation of the laws of the State of Arkansas, and is, therefore, a matter of law which has never been passed upon by any circuit court of appeal other than that of the Eighth Circuit.

Petitioners state in their petition that the Eighth Circuit Court of Appeals has decided a question of local law contrary to and in conflict with local decisions and the law of the State *at the time of the issuance of these bonds.* While we have shown that there has been no change in its decisions by the Supreme Court of Arkansas, the Eighth Circuit Court of Appeals was constrained to follow the latest decision of the Arkansas Supreme Court under the rule in the case of *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64, even had there been such a change.

Petitioners also contend that the Eighth Circuit Court of Appeals decided an important question of federal law which has not been but should be settled by this court. It is patent that the only propositions of federal law involved herein are the questions of impairment of a contract by an alleged change in its decisions by a state court, and whether a federal court should follow the decisions of the courts of the state in which the suit is brought, both of which questions have been passed upon by this Court numerous times.

At different places in their brief, petitioners go outside of the record in an attempt to convey the idea that the issues in this case are of such importance and the decision will be of such far-reaching consequence that there has never been a question of higher or greater importance before this Court. And we, with equal propriety, go outside of the record to state the fact that the effect of this decision will be very limited, because over 95% of the school districts of Arkansas have refunded their outstanding bonds under the provisions of Act 169 of 1931 and have voted continuing millage taxes for their respective building funds, so that neither they nor their bondholders are any longer interested in or affected by any decision as to rights of bonds issued prior to Act 169 of 1931.

We, therefore, respectfully urge that this Court deny the petition for a writ of certiorari.

Respectfully submitted,

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